Re: Franchise Rule Staff Report

Filed Electronically

Federal Trade Commission

Steven Toporoff, Attorney

Eileen Harrington, Associate Director,
Division of Marketing Practices

J. Howard Beales, III, Direcor
Bureau of Consumer Protection

Re: Comments on Staff Report to the Federal Trade Commission and Proposed Revised Trade Regulation Rule, Disclosure Requirements and Prohibitions Concerning Franchising (16 CFR Part 436)

Dear Mr. Toporoff, Ms. Harrington and Mr. Beales:

Thank you for your exhaustive work on the staff report, and for the opportunity to comment. Our firm represents exclusively franchisees in franchise related matters, and cannot help but approach the Staff Report and the NPR from the perspective of a prospective franchisee. In our wider practice, however, we represent various businesses and individuals, and bring an understanding of both franchisors' and franchisees' business needs and objectives to our comments.

First, we join the general franchisee community in expressing our disappointment that there has been no action toward Federal regulation of the franchise relationship. We understand the Committee's conclusion that the Act does not authorize comprehensive relationship regulation under the Rule. However, there is clearly room within the accepted regulatory arena for rules which would reduce the abuses which drive the calls for relationship regulations. The NPR includes at least two such areas: confidentiality agreements and integration clauses.

Second, as may be seen in our specific comments below, we believe the Staff Report overestimates the sophistication of potential franchisees, and is too restrictive in its discussion of the purpose of required disclosures. In the public perception, the fact that a business is a "franchise" is an unambiguous selling point, probably far in excess of the value that fact alone brings to the particular business: clients frequently tell us they wanted to "buy a franchise," not "start a business" or "sell hamburgers." Franchisors' disclosure documents are not written haphazardly, but are generally carefully drafted with the goal of satisfying the minimum regulatory requirements without scaring away prospects. Prospective franchisees almost always have less experience reading UFOCs than the franchisors' attorneys have in drafting them. Thus, the Rule should always err in the direction of greater disclosure.

Specific Comments:

1. History of Specific Unit - Item 20(4) (Section 436.5(t))

We agree with the Illinois Attorney General's suggestion that the prospective buyer be given a detailed site history if it is being directed to a particular franchised location. The proposed addition to Item 20 is generally satisfactory. The Staff recommendation that the time period be reduced to three years should not be followed. Even a five year history is only long enough to discern the most egregious trends: A franchise which failed on average every two years might only show a single sale in the suggested five year history. A better rule would require at least a ten year transaction history (i.e., the number of ownership transfers). Item (i) could be restated as follows:

"The number of transfers of the franchise in the past 10 fiscal years, and for the last five fiscal years, the name and last known address and telephone number of each previous owner of the outlet."

2. Confidentiality Clauses - Item 20(7) (Section 436.5(t))

Franchise systems which include genuine trade secrets or valuable confidential information have a right to protect it by insisting on confidentiality. The suggested Item 20(7) should clearly distinguish between agreements which protect this legitimate interest and those which generally prohibit franchisees (or ex-franchisees) from discussing their impressions of the system or their relationship with the franchisor. Permitting this second type of confidentiality agreement contradicts the philosophy behind required disclosures underlying the Franchise Rule. Requiring the disclosure of the names of franchisees and former franchisees, but accepting that the disclosed individuals may be contractually forbidden to discuss the franchisor with a prospective franchisee makes little sense.

However, if the Commission remains determined to permit this, the suggested disclosure statement should be amended to state:

"In some instances, we have required current and former franchisees to sign provisions restricting their ability to speak openly...."

The voluntary statistical reporting should be made mandatory. Additionally, the Commission should consider whether its time frames are too short. Three fiscal years is not long in the context of franchise agreements which commonly run for ten or fifteen years. A better time frame might be the previous five fiscal years, or half the length of the currently offered franchise term, whichever is longer.

3. Franchisee Associations - Item 20(8) (Section 436.5(t))

We agree with the Staff recommendation to retain the proposed trademark specific association disclosure, with one change. Item (ii) should not be limited to "incorporated" organizations, but open to any organization which requests inclusion. The burden on the franchisor would be minimal - merely maintaining a list of

organizations which request inclusion and provide their contact information. Franchisees may organize, but choose for any number of reasons not to incorporate, e.g., California's annual $800 minimum franchise tax. The organizational form is not determinative of the quality of the information it might make available to a potential franchisee.

4. Integration Clauses - Additional Prohibitions (Section 436.9(i))

We fully support the specific prohibition on requiring waivers of reliance on the disclosure documents (although we question the ultimate enforceability of such a waiver). However, the prospective franchisee, in making its decision, should be able to rely on all written information prepared or provided by the franchisor. Claims in a brochure designed and intended to promote franchise sales should not be overridden by language buried somewhere in a hundred page disclosure document. The Staff acknowledges that "there is some merit in the argument that franchisors should not disclaim or waive any authorized statement outside the disclosure document..." but backs off from the obvious conclusion by claiming to limit its "concern to the reliability and integrity of the franchisor's required disclosures." The required disclosures are neither made nor reviewed in a vacuum. If salesmanship trumps legalese in the prospective franchisee's mind, the disclosures have not done their job. Permitting integration clauses which invest with the force of law the false statement that the franchisee limited its reliance to the disclosure documents undermines both the reliability and the integrity of the required disclosures.

Thank you again.

Bruce Napell
Peter Singler
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